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Proposed FINRA Rule 2231 Governing Customer Account Statements

Through its recent Regulatory Notice 14-35, the Financial Industry Regulatory Authority (“FINRA”) announced and sought comments on its proposed new Rule, FINRA Rule 2231, governing the frequency and availability of customer account statements. This was the third solicitation for comments sought by FINRA for the proposed Rule. The first was announced in April 2009 through SR-FINRA-2009-028 (the “Initial Filing”) and the second in Amendment No. 1 to the Initial Filing. Twelve comment letters were received in response to the Initial Filing and 8 comment letters in response to Amendment No. 1. Through Regulatory Notice 14-35, FINRA seeks comment on the revisions made in light of these comment letters.

In its Initial Filing, FINRA proposed to transfer NASD Rule 2340 and NYSE Rule 409 into the consolidated FINRA Rulebook as FINRA Rule 2231, but only after incorporating significant changes to these existing Rules. Specifically, FINRA sought to increase the frequency at which customer account statements must be sent to customers, requiring member firms to deliver customer account statements “at least once every month to each customer whose account had activity during the period” as opposed to the current quarterly delivery. FINRA also sought to transfer provisions from the current NYSE Rule 409 which only permit customer account statements to be sent to third parties if the customer provides written authorization. These, and other proposals contained in the Initial Filing, sought significant and substantive changes to the policies governing the delivery and availability of customer account statements, and commenters' feedback was overwhelmingly negative.

With regard to the proposal regarding the frequency for delivery of customer account statements, all 12 comment letters received in response to the Initial Filing objected to the proposed monthly delivery requirement. In addition to other concerns, the chief complaints raised by commenters were that the monthly delivery requirement would (1) “result in significant costs for the industry without meaningful benefits for customers”, (2) create conflicts with the transaction confirmation requirements under Securities and Exchange Act Rule 10b-10 (requiring a broker-dealer to provide its client written confirmation of a securities transaction at or before completion of the transaction), and (3) create conflicts with member firms' retirement plan reporting obligations. Additionally, commenters pointed out that alternatives such as online account sites and call centers are available to customers wishing to obtain account information more frequently than once a quarter.

With regard to the proposal regarding transmission of customer account statements to third parties, commenters objected to the proposed rule's prohibition on delivery of account

statements to any person other than the customer without the customer's express written consent. Commenters asserted that, in light of the federal protections in place governing the sharing of information in the securities industry, a customer's oral consent to sharing his or her account information should be deemed sufficient. Specifically, institutions not subject to NYSE Rule 409 claimed the FINRA's implementation of the provision would impede firms' ability to share account information and service customers' accounts.

As a result, in July 2011, FINRA filed Amendment No. 1 to its Initial Filing, revising its proposals for FINRA Rule 2231. Amendment No. 1 proposed to retain the current quarterly delivery requirements under certain circumstances, including if the activity in the customer's account was passive or if quarterly statements are allowed by a separate SEC rule or regulation. The Amendment also revised the proposal for transmission of customer account statements to third parties. However, instead of incorporating commenters' suggestions to allow oral consent for delivery to third parties, FINRA retained the written consent provisions, and imposed an additional requirement which necessitated that a duplicate copy of the statement be sent to the customer even where the customer provides written direction to provide the statement to a third party.

The SEC published Amendment No. 1 in August 2011 and received eight (8) comment letters in response. Although commenters had fewer complaints for the revised proposal, they still raised concern regarding FINRA's proposed revisions to the existing quarterly delivery of account statement, again citing the excessive cost of compliance compared to the minimal benefit for customers. Not surprisingly, commenters also took issue with the proposed requirement of sending account statements to customers where the customer has requested, in writing, delivery of the statement to a third party. As a result, in July 2012, FINRA withdrew the Initial Filing to further consider the comments and the direction the new Rule should go.

Two years later, in September 2014, FINRA released its revised proposal, scaling back many of its previous revisions to proposed Rule 2231. Its current proposal, announced in Regulatory Notice 14-35, seeks to transfer current NASD Rule 2340 and NYSE Rule 409 into the consolidated FINRA Rulebook with minimal alterations. In fact, the proposal's only significant change to the current rule is the requirement, first announced in Amendment No. 1, that firms send their customers a duplicate copy of any account statement also sent to a third party. Thus, the revised proposal retains the current quarterly delivery requirement and the NYSE 409's requirement of written consent for customers to direct delivery of their account statements to third parties. Notably, it does not adopt the suggestion of oral consent to delivery of statements to third parties that was made by multiple commenters.

Specifically, with regard to the revised proposal's provisions governing the transmission of customer account statements to third parties, FINRA incorporates the current requirements of NYSE Rule 409 which requires that firms obtain written consent to transmit customer account statements to third parties or send a duplicate copy of the statement to the customer. Where the requirements are disjunctive in NYSE Rule 409, they are both required under the revised proposal. As a result, customers are more limited in their ability to decline receipt of their

statements. However, the revised proposal does specifically provide that member firms can satisfy their delivery obligations electronically, as long as the firms comply with the SEC's established standards on the use of electronic media, thereby lessening the cost and burden imposed by the duplicate delivery.

Finally, the proposal also seeks to transfer additional provisions from the current Rules governing customer account statements without significant alterations. These provisions include requirements (1) to include a disclosure in the account statement regarding the customer's rights under the Securities Investor Protection Act (SIPA), (2) to provide customers unqualified free credit balances, and (3) to excuse quarterly delivery of statements for customer accounts carried solely for execution on a Delivery versus Payment/Receive versus Payment (DVP/RVP) basis (an exception that was added to NASD Rule 2340 in 2006).

The current comment period expires October 31, 2014. The comments received to date acknowledge that the revised proposal is more favorable than earlier iterations and that the primary problems with the earlier versions of the Rule have been addressed and remedied. However, commenters still take issue with the delivery of statements to customers who do not wish to receive them. Specifically, the commenters believe that this could place elderly and/or incapacitated customers at risk of financial exploitation. Commenters call for elimination of the requirement, or at least a strengthening of the measures for verifying the customer's identity. It remains to be seen whether FINRA will amend the Rule in light of these concerns prior to submitting it to the SEC for further comment.

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